

IN THE
United States Court of Appeals
For the Ninth Circuit

SEABOARD FINANCE COMPANY, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

On Petition for Review of the Decision of the Tax Court of the
United States

BRIEF AND APPENDIX FOR THE RESPONDENT

H. BRIAN HOLLAND
Assistant Attorney General

ELLIS N. SLACK
GEORGE F. LYNCH
*Special Assistants to the
Attorney General*

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INDEX

	PAGE
Opinion below	1
Jurisdiction	1
Question presented	2
Statute involved	2
Statement	3
Summary of argument	11
Argument:	
The Tax Court correctly determined that taxpayer's use of foreign exchange in the purchase of the Campbell stock, in accordance with obligations incurred under the purchase agreement of March 27, 1946, did not constitute a transaction in foreign exchange requiring recognition of a taxable gain separate and apart from subsequent sale of the stock	12
Conclusion	23
Appendix	24

CITATIONS

Cases:	
<i>Bernuth Lembcke Co. v. Commissioner</i> , 1 B.T.A. 1051	18, 20, 21, 22
<i>Bowers v. Kerbaugh-Empire Co.</i> , 271 U.S. 170	16
<i>Commissioner v. Ashland Oil & R. Co.</i> , 99 F. 2d 588	20
<i>Commissioner v. Court Holding Co.</i> , 324 U.S. 331	16
<i>Credit & Investment Corp. v. Commissioner</i> , 47 B.T.A. 673.....	21
<i>Helburn, Willard, Inc. v. Commissioner</i> , 20 T.C. No. 106	22
<i>Joyce-Koebel Co. v. Commissioner</i> , 6 B.T.A. 403.....	18, 20, 22
Statute:	
Internal Revenue Code, Sec. 22 (26 U.S.C. 1946 ed., Sec 22)	2
Miscellaneous:	
O. D. 489, 2 Cum. Bull. 60 (1920)	18

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OPINION BELOW

The findings of fact and opinion of the Tax Court (R. 20-48) are reported at 20 T.C. 405.

JURISDICTION

The petition for review (R. 72-74) involves a deficiency in corporate income tax for the taxable year ended September 30, 1947 in the amount of \$70,590.74. A notice of deficiency was mailed to taxpayer on June

28, 1950. (R. 6, 11, 16.) Taxpayer filed a petition for redetermination with the Tax Court on September 15, 1950 (R. 3), under the provisions of Section 272 of the Internal Revenue Code. The decision of the Tax Court was entered on May 21, 1953, and served on May 22, 1953. (R. 5, 49.) The case is brought to this Court by a petition for review filed August 21, 1953. (R. 5, 72-74.) Jurisdiction of this Court is invoked under the provisions of Section 1141(a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

QUESTION PRESENTED

Whether the purchase and commitment in March, 1946, of Canadian dollars in an amount equal to the purchase price of the Campbell stock, which was fixed in terms of Canadian dollars, constituted a transaction in foreign exchange requiring recognition of taxable gain separate and apart from the subsequent sale of the stock, where the Canadian dollars increased in value in terms of the American dollar between the date of the purchase of the stock and the date of payment therefor.

STATUTE INVOLVED

Internal Revenue Code:

Sec. 22. GROSS INCOME.

(a) *General Definition.*—“Gross income” includes gains, profits, and income derived from * * * interest, rent, dividends, securities, or the transaction of any business carried on for gain or

profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U.S.C. 1946 ed., Sec. 22.)

STATEMENT

The facts, most of which were stipulated, as found by the Tax Court (R. 21-44), may be summarized as follows:

In December 1945, and the early part of 1946, taxpayer, a domestic corporation, engaged in the small loan business, entered into negotiations with Industrial Acceptance Corporation, Limited, a Canadian corporation, hereinafter called Industrial, for the purchase of the capital stock of the Campbell Finance Corporation, Limited, hereinafter called Campbell, a Canadian corporation, engaged in the small loan business in Canada. On January 2, 1946, the capital stock of Campbell consisted of 50,000 shares of common stock all of which was owned by Industrial. (R. 21-23.)

Industrial offered to sell the Campbell stock to taxpayer for a price equal to the net worth of Campbell, according to its books, plus \$1,000,000. In terms of Canadian dollars, Industrial's asking price for the Campbell stock was \$2,214,969.94, cash. (R. 23, 32.) Since it did not have sufficient cash resources, either in capital or ability to borrow, and since it could not pay the cash price and still have funds available with which to finance the operations of Campbell, taxpayer was unable to meet the terms of this offer, except through utilization of the method proposed by tax-

payer and incorporated in a written agreement entered into on March 27, 1946, but effective as of January 2, 1946. (R. 23-24.)

The funds required by taxpayer in order to carry on its activities were derived from three sources: (a) equity capital, consisting of preferred and common stock; (b) bonds or debentures; and (c) money borrowed from banks. In 1946 the banks with which taxpayer did business limited the total amount of unsecured loans to taxpayer at any time to twice taxpayer's equity capital, including as equity capital for this purpose all subordinated obligations. (R. 32.) As a consequence, taxpayer could not borrow the amount of the purchase price of the Campbell stock without upsetting the ratio of equity to borrowed capital which it had to maintain under its credit management with the banks. (R. 32-33.) In order to maintain the required ratio of equity to borrowed capital and at the same time obtain the money with which to meet the terms of the offer, the parties agreed that the purchase of the stock should be accomplished as follows (R. 24-32): the agreed price to be paid for the Campbell stock was \$2,214,696.94 (Canadian currency); immediately following the execution of the agreement Industrial was to deliver to taxpayer the 50,000 shares of Campbell stock; taxpayer was to issue to Industrial 100,000 shares of its authorized common stock and deliver the same to the Canadian Bank of Commerce, in escrow; taxpayer was to submit to the Securities and Exchange Commission a registration statement covering the 100,000 shares of stock; taxpayer was to arrange with brokers to sell the 100,000 shares, and from the pro-

ceeds of such sale Industrial was to receive \$2,214,969-.94—any deficiency to be made up by taxpayer, and any excess to be paid to taxpayer; interest was to be charged upon the purchase price from January 2, 1946, to the date of receipt of the full amount thereof by Industrial at the rate of $4\frac{1}{2}$ per centum per annum, but dividends received by Industrial upon the 100,000 shares were to be credited against the interest; default date was set at November 30, 1946; in order to protect and indemnify Industrial against any loss that might arise from the taxpayer's election to repurchase its 100,000 shares prior to their sale, or from its failure to pay the full purchase price together with interest, taxpayer was to deposit with Industrial cash collateral of \$2,200,000 on which Industrial was to credit interest at the rate of $4\frac{1}{2}$ per centum to taxpayer's account while on deposit; Industrial could use any part of the collateral to supply any deficiency in purchase price, resulting from sale of the 100,000 shares of taxpayer's stock; the payment, deposit, exchange, adjustment or distribution of money involved under the agreement was to be in Canadian funds in the City of Montreal, except that in the event the sale of the 100,000 shares resulted in an excess over and above that to which Industrial was entitled, such excess was to be paid to taxpayer in whatever funds or currency the excess existed.

At the time that the negotiations for acquisition of the Campbell stock were being carried on, taxpayer had a line of credit with the bank of Manhattan Company in the amount of \$2,000,000 (United States), and that bank was willing to loan taxpayer that amount for

use in connection with the agreement of March 27, 1946. (R. 34.)

On March 27, 1946, taxpayer through its stock transfer agent in New York City, issued, as an original issue, 100,000 shares of its common stock in the name of Industrial, and caused that stock to be delivered to the Canadian Bank of Commerce, to be held in escrow. From and after the date of issuance, Industrial appeared on the stock transfer records and on the share register of taxpayer as the owner of 100,000 shares of the common stock of taxpayer. (R. 34.)

On January 28, 1946, prior to the issuance of the 100,000 shares of taxpayer's stock to Industrial, taxpayer's counsel sent a letter to the Securities and Exchange Commission, reciting in part that taxpayer believed it would be enabled to purchase a Canadian finance company on the basis of issuing in payment therefor certain shares of its common stock on condition that it would guarantee to the seller (Industrial) that it could find a purchaser to distribute the stock to the public within the ensuing seven or eight months; that the issued shares were to be held in escrow with a bank until such time as a registration statement was in effect; that the financing of the purchase contemplated the sale of the shares through an underwriter for the purpose of providing additional capital to taxpayer; and that unless the transaction was handled in the form of the issuance of stock in payment for the property, taxpayer would be required to issue a note or other paper obligation which would show up on its balance sheet as a quick liability, thus defeating somewhat the purpose of the transaction, whereas the is-

suance of stock with a contingent liability only to find an underwriter would not adversely affect taxpayer's balance sheet. In response to the question asked relative to the proposed method of financing the purchase, a member of the Securities and Exchange Commission replied by letter dated February 6, 1946, that he would not be inclined to raise any objection to the postponement of registration until such time as the offering to the public occurred. (R. 34-37.)

On March 27, 1946, Industrial caused to be transferred and delivered to taxpayer a certificate or certificates evidencing 50,000 shares of the common stock of Campbell. Thereafter, and until taxpayer sold the Campbell stock, taxpayer appeared on the stock transfer records and the share register of Campbell as the owner of the 50,000 shares which constituted all of Campbell's capital stock. (R. 37.)

On or about March 30, 1946, taxpayer issued its check to the Canadian Bank of Commerce in the amount of \$2,000,000 United States dollars, with instructions to buy \$2,200,000 in Canadian dollars for taxpayer's account. The Canadian dollars so purchased were deposited with Industrial pursuant to the agreement of March 27, 1946. Industrial acknowledged receipt of the deposit. The \$2,000,000 United States dollars were borrowed by taxpayer from the Bank of Manhattan Company. (R. 37.)

On August 29, 1946, taxpayer filed a registration statement (which became effective on November 22, 1946) with the Securities and Exchange Commission registering 50,000 shares of series A cumulative preferred stock and 200,000 shares of common stock. The

prospectus which was prepared and filed as part of the registration statement recited in part that under the terms of the purchase and sale agreement, taxpayer had issued, in payment for all the 50,000 outstanding shares of common stock of Campbell, 100,000 shares of its common stock, which shares had been deposited in escrow with the Canadian Bank of Commerce pending the completion of arrangements by taxpayer with investment bankers for the public sale of the 100,000 shares for the account of Industrial and the registration of that stock. (R. 38.)

Under date of November 22, 1946, taxpayer and Industrial entered into an agreement with an underwriting firm pertaining to the shares registered as described above. That agreement provided in part that taxpayer proposed to issue and sell an aggregate of 100,000 shares of common stock of the par value of \$1 each, and Industrial proposed to sell an aggregate of 100,000 shares of outstanding common stock of the par value of \$1 each of the taxpayer. (R. 39.)

Of the 200,000 shares of common stock registered, 100,000 shares, constituting those shares which had been issued to Industrial by taxpayer, were offered for sale to the public on or about November 22, 1946. The net proceeds from the sale thereof was \$1,440,000. (R. 40.)

The agreement between taxpayer and Industrial was concluded in accordance with the terms of a letter dated November 30, 1946, whereby Industrial authorized the bankers to pay taxpayer the net proceeds of the sale (\$1,440,000), and taxpayer authorized Industrial to charge against the \$2,200,000 collateral deposit

held by it an amount equal to the net proceeds from the sale of the stock and to deduct the balance of the purchase price from that deposit. (R. 40-41.)¹

On March 27, 1946, and April 1, 1946, the official exchange ratio of the Canadian dollar to the United States dollar was .9090. In November and December, 1946, the official exchange ratio of the Canadian dollar to the United States dollar was par, less one-half of 1 per cent on conversion, or an effective ratio of .995, which had been in effect since July 5, 1946. (R. 42.) Applying this exchange ratio, taxpayer computed and reported in its income tax return for the year ended September 30, 1947, a long-term capital gain of \$189,000 (United States dollars) which it designated as "Conversion gain on \$2,000,000.00 deposit." (R. 14.) This computation was based on the fact that on November 30, 1946, when taxpayer authorized Industrial to apply the cash deposit against the purchase price of the Campbell stock, the \$2,200,000 (Canadian) had a value of \$2,189,000 (United States) as compared with a value of \$2,000,000 (United States) in March, 1946, when the Canadian dollars were purchased. (R. 42, 45.) Taxpayer treated the gain so computed as resulting from a transaction in foreign exchange and as having taken place in Canada and took it into account in computing the credit to which it was entitled on ac-

¹ As the Tax Court pointed out (R. 46-47) there is a difference of \$14,969.94 (Canadian) not accounted for by these transactions. Since the record failed to show in what manner it was discharged or at what point the complicated accounts between taxpayer and Industrial took it into effect, the Tax Court disregarded that "comparatively small element" both for failure of proof and because it appeared not to be in controversy.

count of income taxes paid to the Dominion of Canada. (R. 9, 17, 45.) The effect was to increase the proportion taxpayer's income from sources within Canada to its income from all sources, and thus increase the amount of the credit allowable under Section 131 of the Internal Revenue Code. The Commissioner determined that no taxable gain resulted in connection with the transaction whereby the Campbell stock was purchased and accordingly eliminated the reported gain from taxpayer's income for the taxable year. (R. 14.)

In addition to the facts set forth above, the Tax Court found (R. 44) that Industrial did not want to become, and did not intend to become, a stockholder of taxpayer; that taxpayer did not want Industrial to become a stockholder; that taxpayer was not a dealer, trader, speculator, or investor in foreign exchange; that taxpayer sold all of its Campbell stock on December 31, 1946, and concluded (R. 44) that

Petitioner's [taxpayer's] use of foreign exchange in the purchase of the Campbell stock, in accordance with obligations incurred under the purchase contract of March 27, 1946, did not constitute a transaction in foreign exchange requiring recognition of a taxable gain separate and apart from the subsequent sale of the stock.

The Tax Court also found that the Commissioner had properly eliminated the gain on foreign exchange reported by taxpayer in its return for the taxable year involved.

SUMMARY OF ARGUMENT

By an agreement dated March 27, 1946, taxpayer agreed to purchase the stock of a Canadian corporation for a fixed price in terms of Canadian dollars. Since Industrial, the owner of that stock, wanted payment in cash, and since taxpayer did not have sufficient resources either in cash or ability to borrow, it was agreed that the cash payment demanded could be effected by the method provided in the agreement.

Accordingly, the agreement provided, in form, that taxpayer would issue 100,000 shares of its own stock to Industrial, ostensibly in exchange for the 50,000 shares of Campbell, the Canadian corporation; that it would simultaneously deposit with Industrial, as security for the payment of the agreed purchase price, a covering amount (\$2,200,000) in Canadian dollars; that it would undertake to sell the 100,000 shares of stock which it issued, guaranteeing to pay Industrial any deficiency in the event the proceeds from such sale were insufficient to meet the agreed purchase price of the Campbell stock.

Since taxpayer's ability to borrow was limited to twice its equity capital, it was only as a result of its issuance of the 100,000 shares, that it was able to borrow the sum of \$2,200,000 (U.S.) which it used to purchase the collateral deposit of \$2,200,000 (Canadian) which it was required to make.

Subsequently, in November, 1946, the proceeds from the sale of the 100,000 shares having netted less than the amount of the agreed purchase price, taxpayer authorized Industrial to apply the deposit of \$2,200,000

(Canadian) in payment of the agreed purchase price, the proceeds of the sale of the 100,000 shares being credited to the account of the taxpayer.

Since the cost of the Campbell stock was to be determined in terms of the exchange rate prevailing on the date of its purchase, March 27, 1946, and since, under the terms of the agreement, the \$2,200,000 (U.S.) was, on that date, committed, in terms of Canadian dollars, to the agreed purchase price of that stock, any subsequent increase in the Canadian exchange rate could not serve to increase the purchasing power of the \$2,000,000 (U.S.). Under these circumstances, the Tax Court correctly found that taxpayer's use of foreign exchange in the purchase of the Campbell stock did not constitute a transaction in foreign exchange requiring recognition of a taxable gain separate and apart from the subsequent sale of that stock.

ARGUMENT

The Tax Court Correctly Determined That Taxpayer's Use of Foreign Exchange in the Purchase of the Campbell Stock, in Accordance With Obligations Incurred Under the Purchase Agreement of March 27, 1946, Did Not Constitute a Transaction in Foreign Exchange Requiring Recognition of a Taxable Gain Separate and Apart From Subsequent Sale of the Stock

It is clear from the terms of the agreement of March 27, 1946, (R. 24-32), that taxpayer agreed to purchase from Industrial the 50,000 shares of Campbell stock at a fixed price, in terms of Canadian dollars, of \$2,-214,969.94. Taxpayer's assertions that the Tax Court erred in finding to that effect (Br. 13, 20) ignore the plain language of the agreement as well as the stipu-

lated facts (Appendix, *infra*).² Thus, the many references in the agreement (R. 25, 27, 29, 30, 31, 39, 43), which clearly show that the agreed purchase price for the Campbell stock was \$2,214,969.94, find specific confirmation in the stipulated facts which provide in part that (Stip. par. 10):

At the time of the execution of the agreement * * * [taxpayer] was not in a position to pay out cash in the amount specified in the agreement (\$2,-214,969.94 Canadian) for the Campbell stock.

It is not true, therefore, as taxpayer asserts (Br. 21) that all it paid or agreed to pay on March 27, 1946, for the Campbell stock was 100,000 shares of its own common stock. The issuance of those 100,000 shares of stock to Industrial, purportedly in exchange for the 50,000 shares of Campbell stock, was necessitated by the fact that Industrial wanted payment in cash (R. 23, 53-54, 71), and taxpayer did not have sufficient cash resources, either in capital or ability to borrow, with which to meet Industrial's asking price in cash (R. 23; Stip. par. 10). Since taxpayer's borrowing capacity was limited to twice its equity capital (R. 32), it was necessary, in order to finance the purchase, that taxpayer increase its equity capital, so that its ratio of borrowed to equity capital would be maintained within

² Although the Stipulation of Facts was not printed as part of the printed record on this appeal, it now appears that particular parts of the language therein are necessary for a proper consideration of this case. Accordingly the Commissioner has printed the stipulation as an appendix to this brief, and by appropriate motion accompanying this brief requests this Court to accept such stipulation as part of the printed record herein.

the limits imposed by the banks with which it was doing business (Stip. par. 10). At the time the negotiations for the purchase were being carried on, taxpayer had a line of credit in the amount of \$2,000,000 (U.S.) with the Bank of Manhattan which was willing to loan that amount to taxpayer for use in connection with the agreement to purchase the Campbell stock. (Stip. par. 10.)

Although Industrial wanted cash (R. 23, 53), not stock (R. 44) in payment for the Campbell stock, it was willing to go along with the proposed issue of 100,000 shares of the taxpayer's stock as a means of financing the purchase, provided taxpayer, while undertaking to sell those shares for the account of Industrial, would guarantee to Industrial payment of the stipulated cash price, in Canadian dollars, agreed upon. Accordingly, under the contract, the agreed price for the Campbell shares was to be paid from the proceeds of a public sale of the 100,000 shares to be issued by taxpayer, with any deficiency to be made good either from the issuance and sale of additional shares, or by payment in cash. (R. 25.) In order to guarantee full payment of the agreed purchase price of \$2,214,969.94 (Canadian) to Industrial, it was agreed that concurrently with the transfer and delivery of the 50,000 shares of Campbell stock to it, taxpayer would deposit with Industrial as cash collateral security the sum of \$2,200,000 in Canadian currency.³ (R. 29-30; Stip. par. 15.) It was only by utilization of this method that taxpayer was able to meet Industrial's demand that the payment of the purchase price be made in cash. (R. 23, 32.)

³ See footnote 1.

Coincident with the issuance of the 100,000 shares of its stock to Industrial, taxpayer issued its check to the Canadian Bank of Commerce in the amount of \$2,000,000 (U.S.) with instructions to buy \$2,200,000 (Canadian) for its account, the money having been borrowed from the Bank of Manhattan. (R. 37, 45; Stip. par. 14, 15.) Canadian dollars in the required amount were purchased and deposited with Industrial pursuant to the terms of the agreement. (R. 37.) Thus, in March, 1946, payment of the agreed purchase price of \$2,214,969.94 in Canadian dollars was assured.

By the end of November, 1946, when the 100,000 shares had been sold, the proceeds amounted to \$1,440,000, netting \$14.40 per share, which was the approximate market value of the stock during the time the agreement to purchase was being negotiated. (R. 33, 40, 41.) On November 30, 1946, taxpayer authorized Industrial to apply the cash deposit of \$2,200,000 (Canadian) against the purchase price of the Campbell stock, with instructions to it to cause the 100,000 shares of stock, which had been held in escrow pending the filing of a registration statement with the Securities and Exchange Commission,⁴ to be delivered to the

⁴ Taxpayer seeks to capitalize (Br. 13-15) on the statement in the Tax Court's opinion (R. 45) that "As security * * * [taxpayer] was required to deposit in escrow \$2,200,000 Canadian, as well as the shares of its stock, pending the completion of the details of sale." Although that sentence is in part a misstatement of the stipulated facts in that the \$2,200,000 was not deposited "in escrow", and the shares of stock were not deposited as "security" for the purchase price, nevertheless, it is clear that such misstatement was only that and not an interpretation of the facts leading to reversible error, and it does not appear to us that taxpayer contends otherwise.

brokers with instructions to them to credit the proceeds of the sale of those shares to taxpayer's account. (R. 41.) At that time, the deposit of \$2,200,000 (Canadian) had a value, based upon the Canadian exchange rate then prevailing, of \$2,189,000 (U.S.). (R. 42, 45.) Ignoring the fact that the purchase money had already been converted to Canadian dollars in March, and at that time applied to the purchase, taxpayer made a computation based upon the erroneous assumption that payment had been made at the exchange rate prevailing in November or December 1946, thus attempting to show a gain of \$189,000 (U.S.) This was done on the theory that it required that much less in American money to meet the agreed purchase price in November or December, than was required in March, when the Canadian dollars were purchased. Such, however, was not the fact.

It is axiomatic that taxation is an intensely practical matter, concerned with economic realities and that tax consequences flow from the substance of a transaction rather than from the form in which it is cast. *Commissioner v. Court Holding Co.*, 324 U.S. 331; *Bowers v. Kerbaugh-Empire Co.*, 271 U.S. 170, 174. In the instant case, as has been pointed out, the purchase price of the Campbell stock had been fixed in March, 1946, at \$2,214,969.94 in terms of Canadian dollars. At the same time, taxpayer purchased a covering amount of Canadian dollars which it deposited with Industrial, as required by the agreement, thus in reality effecting payment for the Campbell stock at that time. Since the deposited purchase money was thus appropriated to the fixed contract price, both expressed in Canadian

dollars, no fluctuation upward in the Canadian exchange rate after March, 1946, could produce any economic gain to taxpayer in terms of the purchasing power of the \$2,000,000 (U.S.) which it had expended, much less taxable consequences. With cost basis of the Campbell stock established and the purchasing power of the \$2,000,000 (U.S.), pegged, in terms of Canadian dollars, to that fixed and agreed purchase price, the foreign exchange aspects of the instant transaction were stabilized for federal income tax purposes. Thereafter any fluctuations upward in the Canadian exchange rate could have no effect on the purchasing power of the \$2,000,000 (U.S.) since the fixed purchase price of the Campbell stock in terms of Canadian dollars and the value of the Canadian dollar would move upward together.

It is clear, then, that the purchase and application of the foreign exchange (Canadian dollars) was by the terms of the contract itself, a fixed and integral part of the purchase of the Campbell stock. The fact that the payment of the agreed purchase price and the covering deposit were required in Canadian dollars effectively precluded any speculation in foreign exchange in connection with the purchase of the Campbell stock. Taxpayer, however, seeks to show a separate transaction in foreign exchange by contending (Br. 15-19) that it entered into a "speculative agreement" for the purchase of 50,000 shares of Campbell stock. While taxpayer may have been speculating with respect to whether or not the proposed sale of the 100,000 shares of stock which it issued would produce the amount of the agreed purchase price, that aspect of

the transaction did not have, and could not have, any bearing on the foreign exchange aspects of the transaction, which, as pointed out, had already been fixed and determined in March, 1946, coincident with the purchase and delivery of the Campbell stock. Thereafter, any increase in the value of the 100,000 shares of stock issued by taxpayer would only serve to decrease the amount of any deficiency which taxpayer would have to pay in the event the proceeds from their sale proved to be less than the amount of the agreed purchase price of the Campbell stock. Any increase in the value of those shares could not, however, affect the purchasing power of the \$2,000,000 (U.S.) which, in terms of converted Canadian dollars, had already been committed to the purchase of the Campbell stock on March 27, 1946.

As the Tax Court pointed out (R. 46), the cost of the Campbell shares was to be determined at the rate of exchange prevailing at the date of purchase, March 27, 1946, and not, as taxpayer contends (Br. 11), on the date of actual payment, in November or December. See *Bernuth Lembcke Co. v. Commissioner*, 1 B.T.A. 1051 (Acquiescence, IV-2 Cum. Bull. 3), and *Joyce-Koebel Co. v. Commissioner*, 6 B.T.A. 403 (Acquiescence, VI-2 Cum. Bull. 4).⁵ Here the price of the

⁵ Taxpayer's position in this regard is based upon a ruling of the Commissioner published as O.D. 489, 2 Cum. Bull. 60 (1920). It appears, however, that the acquiescences entered by the Commissioner with respect to the *Bernuth-Lembcke* and *Joyce-Koebel* cases, which were decided at a later date, indicated the Commissioner's abandonment of O.D. 489, and acceptance of the date of purchase as the controlling date for determining the cost of a commodity purchased with foreign exchange.

Campbell stock was fixed in Canadian dollars by the terms of the agreement and cash was placed in the seller's (Industrial's) hands at the inception of the agreement. When final payment was effected some eight or nine months later, the purchase price, expressed in terms of Canadian dollars, was still the same. Under these circumstances it is inconceivable that because there was a difference in the exchange ratio between the American and Canadian currencies on the two dates, foreign exchange gain can be spelled out of the purchase of the Campbell stock. As taxpayer, itself, recognizes (Br. 11-12) there must be a conversion of the foreign currency in order that gain or loss may be deemed to have been realized. The only conversion which took place in the instant case, however, occurred in March, 1946, when the Canadian dollars were purchased and committed to the purchase of the Campbell stock in accordance with the terms of the agreement. On or after November 30, 1946, when taxpayer authorized application of the deposited Canadian dollars against the agreed purchase price, there was no conversion of the sum deposited back to United States dollars or another purchase of \$2,214,969.94 (Canadian) at the exchange rate then in effect in order to consummate the transaction. Rather, at that time, Industrial merely authorized the underwriters to pay the proceeds of the sale of the 100,000 shares of stock to taxpayer in United States dollars, while at the same time crediting the deposited Canadian dollars against the agreed purchase price. Under these circumstances, it requires a very strained and artificial interpretation of this purchase agreement to derive from it

a separate transaction in foreign exchange resulting in a gain, separate and apart from the purchase of the Campbell stock. The comment of the court in *Commissioner v. Ashland Oil & R. Co.*, 99 F. 2d 588 (C.A. 6th), would appear to be in point; there it was stated in part (p. 591):

And without regard to whether the result is imposition or relief from the taxation, the courts have recognized that where the essential nature of a transaction is the acquisition of property, it will be viewed as a whole, and closely related steps will not be separated either at the instance of the taxpayer or the taxing authority.

The case of *Bernuth Lembcke*, *supra*, cited by the taxpayer (Br. 12), supports the position of the Commissioner rather than that of the taxpayer. We have already cited that case for the proposition that where property is purchased at a price expressed in foreign currency, the cost of the property should be entered at the exchange rate, in terms of American currency, prevailing at the date of purchase, not the rate at the date of payment. Examination of that case also shows, that the foreign exchange (pounds sterling) which was used to purchase the creosote oil were purchased independently of the oil purchase, and that at the time of the purchase of the pounds sterling taxpayer had no fixed obligation expressed in pounds sterling with respect to the creosote oil. At the time he later incurred such a fixed obligation in terms of pounds sterling, upon his purchase of creosote oil, the purchasing power of the pound in terms of American dollars had declined as a

result of an intervening fluctuation downward in the exchange rate. Accordingly, the Board of Tax Appeals correctly found, on the basis that the transactions was separate and distinct, that a tax loss had been sustained.

The *Joyce-Koebel* case, *supra*, also cited by taxpayer (Br. 12), merely stands for the same basic principle as the *Bernuth Lembcke* case, *supra*. In that case, however, the Board of Tax Appeals recognized that since taxpayer therein was speculating or investing in foreign exchange by virtue of the fact that he purchased credit expressed in terms of pounds sterling, rather than making payment at the time of purchase, any gain or loss from the fluctuation of the foreign currency was to be accounted for as a separate transaction. As has been pointed out, the instant case did not involve a speculation or investment in foreign exchange.

Neither does the case of *Credit & Investment Corp. v. Commissioner*, 47 B.T.A 673, which taxpayer also relies on (Br. 12), require any different result from that for which we here contend. In that case, the taxpayer, an American corporation, purchased a bond of a German corporation, payable in dollars. In 1935, taxpayer received payment for the balance due on its bond in blocked marks, and shortly thereafter invested a portion of those marks in other German securities which it sold during the taxable year, receiving blocked marks which it immediately converted into dollars. The Board of Tax Appeals held that a completed transaction resulted from the payment in blocked marks in 1935 of the bond which taxpayer had acquired in 1926,

and that the investment of a portion of the blocked marks in German securities was a separate and distinct transaction, so that when taxpayer sold the securities it sustained a loss measured by the difference between the value in dollars of the blocked marks at the time of purchase and the amount realized from the sale.

Taxpayer also quotes (Br. 23-24) from the concurring opinion of Judge Opper in *Willard Helburn, Inc. v. Commissioner*, 20 T.C. No. 106, to the effect that since a collateral transaction in foreign exchange "may be involved" in the purchase of a particular commodity, the full scope of a taxpayer's gain or loss will not be given effect in his tax liability unless the foreign exchange transaction is also dealt with. Taxpayer's complaint in this respect must fall of its own weight for the Tax Court's conclusion that there was no gain on the foreign exchange aspect of the instant transaction separate and apart from the subsequent sale of the Campbell stock was made only after giving full effect to the foreign exchange feature of the transaction with the resulting determination that it constituted an integral part of the purchase arrangement, having no separate and distinct tax consequences.

Taxpayer's further argument (Br. 19-23) that it could not determine the cost of the Campbell stock on March 27, 1946, the purchase date, is also without merit, and stems from its refusal to accept the fact, demonstrated above, that the agreed purchase price for that stock was \$2,214,969.94 (Canadian). Since under the doctrine of the *Bernuth Lembcke* and *Joyce-Koebel* cases, the cost of the Campbell stock was to be

determined in terms of the exchange rate prevailing on the date of purchase, March 27, 1946, its cost in terms of American dollars could easily have been determined, as the Tax Court pointed out (R. 47-48), by the mere mathematical process of converting the \$2,-214,969.94 (Canadian) into American dollars at the then prevailing rate of exchange.

CONCLUSION

The decision of the Tax Court is correct and should be affirmed.

Respectfully submitted,

H. BRIAN HOLLAND

Assistant Attorney General

ELLIS N. SLACK

GEORGE F. LYNCH

*Special Assistants to the
Attorney General*

FEBRUARY, 1954

APPENDIX

THE TAX COURT OF THE UNITED STATES

Docket No. 30554

SEABOARD FINANCE COMPANY, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.**Stipulation of Facts**

Petitioner and respondent, through their respective counsel, hereby stipulate that the following facts are true and may be received by the Court in this proceeding, reserving, however, to each party the right to object to any such facts on the ground of materiality or relevance, and the further right to introduce other or further evidence not inconsistent herewith:

(1) Petitioner is a corporation organized and existing under the laws of the State of Delaware. Its principal business office is located at 945 S. Flower Street, Los Angeles 15, California. Its books and records are maintained on the basis of a fiscal year ending September 30 of each year. Its federal income tax return for the fiscal year ended September 30, 1947, was filed in the office of the Collector of Internal Revenue for the 6th District of California at Los Angeles, California.

(2) Petitioner is engaged in the small loan business. Said business consists of making secured and unsecured loans to necessitous borrowers, usually individuals. During the period here in question the average loan made by petitioner was \$310.00.

(3) In 1946 Campbell Finance Corporation Limited (hereinafter called "Campbell") was a corporation organized and existing under the laws of the Province of Ontario, Dominion of Canada. It was then engaged in the small loan business in Canada, operating approximately 50 offices, with aggregate loans outstanding as of March 31, 1946 of approximately \$5,965,802 (Canadian).

(4) In January, 1946, Campbell had 50,000 shares of common stock issued and outstanding, said shares being the only issued and outstanding shares of stock of said corporation. On and immediately prior to January 2, 1946, all of said shares of stock were owned by Industrial Acceptance Corporation Limited, a Canadian corporation (hereinafter called "Industrial").

(5) There is attached hereto as Exhibit "A-1" a copy of an agreement between Industrial and petitioner relating to the 50,000 shares of Campbell stock. There is attached hereto as Exhibit "B-2" a copy of a letter dated February 9, 1946, sent by petitioner to Industrial.

(6) Industrial's principal business is, and was, except for its ownership of Campbell stock, the discounting of commercial installment paper for Canadian dealers in automobiles, furniture, farm implements, and other property. It was not actively engaged in the small loan business as such except through its ownership of the Campbell stock. Industrial had acquired all of the Campbell stock in 1940, holding it until the end of World War II as a means of compensating for the decline in its regular business of discounting paper, said business having declined during the war period

because of shortage of automobiles and other equipment.

(7) In August, 1946, Industrial offered for sale to the public \$2,000,000 of its 3½% Twenty-year Sinking Fund Debenture Series "A", and, under date of August 26, 1946, circulated a prospectus relating to said offer. Said prospectus contained the following statement relative to Campbell Finance Corporation Limited:

"In 1940 when it became evident that the manufacture of automobiles, radios, refrigerators and other durable consumer goods would be curtailed for the duration of the war the Company purchased all of the capital stock of Campbell Finance Corporation Limited (then known as Campbell Auto Finance Company Limited) in order to provide another avenue for the employment of the Company's resources. The business of Campbell Finance Corporation Limited consisted principally of making small loans under the Dominion Small Loans Act 1939 and operated from its head office in Toronto as well as three branches in the Province of Ontario. Facilities available through the countrywide network of branches of Industrial Acceptance Corporation Limited made it possible to develop a very substantial and profitable small loans business during the intervening years, thus materially assisting the company to maintain its branch organization and earnings.

"With the prospect of the return of instalment sales financing in larger volume than has been en-

joyed by the Company in the past, the Directors entered into an agreement with Seaboard Finance Company, one of the larger personal loan companies in the United States, for the sale of all of the shares of Campbell Finance Corporation Limited as at January 2nd, 1946, at a price which gives Industrial Acceptance Corporation Limited a very substantial profit on its investment. As a result of this agreement the Company will withdraw from the small loans field and will have available for its regular instalment sales finance business all of the capital employed in that business before the war, plus the profit realized. The Company has received 100,000 shares of the common stock of Seaboard Finance Company and the latter has undertaken to arrange for the sale of these shares on or before November 30th, 1946, and has guaranteed to Industrial Acceptance Corporation Limited the receipt of \$2,214,970. Until November 30th, 1946, Seaboard Finance Company may be relieved of this guarantee by returning the shares of Campbell Finance Corporation Limited and making payment of substantial sums of cash to Industrial Acceptance Corporation Limited. Seaboard Finance Company has deposited with the Company cash collateral of \$2,200,000 to guarantee the fulfillment of its obligations.”

(8) The funds required by petitioner in order to carry on its activities are and have been derived from three sources: (a) equity capital, consisting of preferred and common stock; (b) bonds or debentures;

and (c) money borrowed from banks. In 1946 the banks with which petitioner did business limited the total amount of unsecured loans to petitioner at any time to twice petitioner's equity capital, including as equity capital for this purpose all subordinated obligations.

(9) The following table discloses the ratios between petitioner's equity capital, including subordinated obligations, and loans from banks on the dates indicated:

<i>Date</i>	<i>Superior Indebtedness (Bank loans)</i>	<i>Equity Capital & Subordinated Obligations</i>	<i>Bor- rowing Ratio</i>	<i>Ratio had the 100,000 Seaboard shares not been issued to Industrial</i>
Jan. 31, 1946	\$10,750,000	\$ 7,089,157	1.5-1	
Feb. 28, 1946	11,250,000	7,386,673	1.5-1	
Mar. 31, 1946 Before execu- tion of Exhibit "A-1"	13,079,366	7,999,228	1.6-1	
After execution of Ex- hibit "A-1"	17,729,366	9,249,228	1.9-1	2.2-1
June 30, 1946	22,625,000	10,790,427	2.1-1	2.5-1
Dec. 31, 1946 After Sale	21,842,500	12,106,238	1.8-1	2.0-1

(10) At the time of the execution of the agreement (Exhibit "A-1") petitioner was not in a position to pay out cash in the amount specified in the agreement (\$2,214,969.94 Canadian) for the Campbell stock. It was decided that the acquisition of the Campbell stock would have to be accomplished through an issuance of additional shares of petitioner's stock, so that its ratio of borrowed to equity capital would be maintained within the limits imposed by the banks with whom petitioner was doing business. At the time that the negotiations for purchase were being carried on, petitioner had a line of credit with the Bank of the Manhattan Company in the amount of \$2,000,000. The Bank of the Manhattan Company was willing to loan \$2,000,000

(U.S.) to petitioner for its use in connection with the agreement between petitioner and Industrial (Exhibit "A-1").

(11) On March 27, 1946, petitioner, through its stock transfer agent in New York City, issued, as an original issue, 100,000 shares of its common stock in the name of Industrial, and caused the same to be delivered to the Canadian Bank of Commerce, Toronto, Ontario, Canada, to be held in escrow. From and after said date of issuance Industrial appeared on the stock transfer records and on the share register of petitioner as the owner of 100,000 shares of common stock of petitioner. There is attached hereto as Exhibit "C-3" a copy of a letter from petitioner to The Canadian Bank of Commerce, dated April 2, 1946, relative to said 100,000 shares.

(12) On January 28, 1946, and prior to issuance of the 100,000 shares of petitioner's stock to Industrial, Bruce R. Tuttle, Esq., petitioner's counsel, sent a letter to the Securities and Exchange Commission, Washington, D. C., relative to the proposed issue. A copy of said letter is attached hereto as Exhibit "D-4".

(13) On February 6, 1946, Edward H. Cashion, Esq., counsel to the Securities and Exchange Commission, replied to Mr. Tuttle's letter of January 28, 1946. A copy of said reply is attached hereto as Exhibit "E-5".

(14) On March 27, 1946, Industrial caused to be transferred and delivered to petitioner a certificate or certificates evidencing 50,000 shares of the common stock of Campbell. From and after said date, and until petitioner sold said Campbell stock, petitioner ap-

peared on the stock transfer records and the share register of Campbell as the owner of said 50,000 shares, being all of Campbell's issued and outstanding capital stock.

(15) On or about March 30, 1946, petitioner issued its check to the Canadian Bank of Commerce, Toronto, in the amount of \$2,000,000 (U.S.), with instructions to buy, for petitioner's account, \$2,200,000 (Canadian). Canadian dollars in that amount were purchased for petitioner's account and deposited with Industrial pursuant to the provisions of the agreement, Exhibit "A-1". The \$2,000,000 (U.S.) herein referred to was borrowed by petitioner from the Bank of the Manhattan Company. There is attached hereto as Exhibit "F-6" a true copy of the receipt given by Industrial for said deposit. There is attached hereto as Exhibit "G-7" a copy of a letter dated April 1, 1946, from the Canadian Bank of Commerce to petitioner.

(16) During the year 1946 the common stock of petitioner was not listed on any national securities exchange. It was, however, traded in the over-the-counter market. The over-the-counter quotations on the common stock of petitioner on the various dates indicated were as follows:

<i>Date</i>	<i>Bid</i>	<i>Ask</i>
1/9/46	14 $\frac{5}{8}$	15 $\frac{3}{8}$
1/15/46	14 $\frac{1}{4}$	15
3/1/46	13 $\frac{1}{2}$	14 $\frac{1}{2}$
3/15/46	13 $\frac{3}{4}$	14 $\frac{1}{2}$
3/26/46	15 $\frac{3}{4}$	16 $\frac{1}{2}$
3/27/46	16 $\frac{1}{4}$	17

<i>Date</i>	<i>Bid</i>	<i>Ask</i>
4/2/46	17 $\frac{1}{4}$	18
4/15/46	17 $\frac{3}{4}$	18 $\frac{1}{2}$
4/30/46	18 $\frac{1}{2}$	19 $\frac{1}{2}$
5/15/46	18 $\frac{1}{2}$	19 $\frac{1}{4}$
6/3/46	21	22
6/7/46	22	23
7/16/46	21 $\frac{1}{2}$	22 $\frac{1}{2}$
8/27/46	19 $\frac{1}{4}$	20 $\frac{1}{4}$
9/4/46	17	18
9/5/46	16 $\frac{1}{2}$	17 $\frac{1}{2}$
9/27/46	16 $\frac{1}{4}$	17 $\frac{1}{4}$
10/31/46	15 $\frac{1}{2}$	16 $\frac{1}{2}$
11/22/46	16 $\frac{1}{4}$	17 $\frac{1}{4}$

(17) On or about May 4, 1946, petitioner commenced the preparation of a registration statement for filing with the Securities and Exchange Commission, Washington, D. C. Said registration statement was filed on August 29, 1946, and became effective on November 22, 1946, and registered 50,000 shares of Series A Cumulative Preferred Stock and 200,000 shares of Common Stock. A prospectus was prepared and filed as a part of the registration statement. A copy of the prospectus is attached hereto as Exhibit "H-8".

(18) Under date of November 22, 1946, petitioner and Industrial entered into an underwriting agreement with Van Alostine, Noel & Co., Johnston, Lemon & Co., and Crowell, Weedon & Co., pertaining to the shares registered as above described. A copy of said underwriting agreement is attached hereto as Exhibit "I-9".

(19) Of the 200,000 shares of common stock registered as above described, 100,000 shares were offered for sale to the public on or about November 22, 1946. These shares were the shares which had been issued by petitioner in the name of Industrial, as described in paragraph (11) above.

(20) The net proceeds, after deduction of underwriting commissions, from the sale of said 100,000 shares of stock in petitioner were \$1,440,000 (U.S.). On November 30, 1946, petitioner sent a letter to Industrial, a copy of which is attached hereto as Exhibit "J-10". The agreement (Exhibit "A-1") between petitioner and Industrial was concluded in accordance with said letter.

(21) There is attached hereto as Exhibit "K-11" a copy of a letter dated January 3, 1947, from Industrial to Messrs. Haskins & Sells, certified public accountants, to which is attached a copy of a statement prepared by Industrial. Of the items listed in said statement, interest due from Industrial to petitioner, losses guaranteed under the contract, and interest due from petitioner to Industrial (less application of dividends) were all settled by appropriate book adjustments. The dividends in the amount of \$72,000 on the 100,000 shares of petitioner's common stock were actually paid in cash to Industrial. The net balance of \$57,227.40 was actually paid in cash by Industrial. In addition to the foregoing items, petitioner received, as dividends from Campbell prior to December 31, 1946, \$400,000. All of said amounts are expressed in Canadian dollars.

(22) On March 27, 1946, and April 1, 1946, the official exchange ratio of the Canadian dollar to the United States dollar was .9090. In November and December, 1946, the official exchange ratio of the Canadian dollar to the United States dollar was par, less $\frac{1}{2}$ of 1% on conversion, or an effective ratio of .995, which had been in effect since July 5, 1946.

(23) In its federal income tax return for the year ended September 30, 1947, petitioner claimed a credit for taxes paid to the Dominion of Canada in the amount \$230,580.91. The statutory notice of deficiency determined that the credit should be \$153,705.40, in lieu of the amount claimed by petitioner in its return.

CHARLES W. DAVIS

Charles W. Davis

Chief Counsel

Bureau of Internal Revenue

Counsel for Respondent

AUSTIN H. PECK, JR.

Austin H. Peck, Jr.

Counsel for Petitioner

